BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
KENNETH E. SAYNE)

Appearances:

For Appellant: Kenneth E. Sayne, in pro. per.

For Respondent: Mark McEvilly Counsel

O P I N I O N

This appeal is made pursuant to section 18646 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Kenneth E. Sayne for reassessment of a jeopardy assessment of personal income tax in the amount of $9,550 for the period January 1, 1978, through March 18, 1978.

The, sole issue presented by this appeal is whether respondent properly reconstructed appellant's income during the period in issue. In order to properly consider this issue, the relevant facts concerning the issuance of the subject jeopardy assessment are set forth below.

Based upon information obtained from numerous sources to the effect that appellant was engaged in a "fencing" operation, City of Concord law enforcement authorities initiated an investigation into appellant's suspected illegal activity. On March 4, 1978, Detective W. Clough, working in an undercover capacity, was sent to appellant's West Pittsburg residence for the purpose of offering to sell appellant a supposedly stolen television. After conversing with the undercover officer and examining the television, appellant purchased it for $30.. Detective Clough, who represented himself as a hotel employee, then asked appellant if he would be interested in purchasing 15 or 20 television sets which could be stolen from the hotel. Appellant advised the detective that he could “handle" such a purchase, but would need a "couple of days notice in order to get rid of the sets;" On March 16, 1978, Detective Clough approached appellant at his residence with one of the "stolen" hotel televisions. After testing the set, appellant paid Clough $50, and expressed his interest in acquiring the other televisions from the hotel.

Shortly after this second'transaction, Detective Clough obtained a search warrant for appellant's residence; the warrant was executed on March 18, 1978. Among the items discovered during the ensuing search were 111 items of suspected stolen property, including 26 televisions and 14 rings. In addition, $6,500 was found on appellant's person and $35,500 was found in the trunk of his car. Appellant was arrested upon the conclusion of this search and charged with possession of stolen property: he subsequently pled guilty to this charge. In addition, appellant was later convicted of three counts of perjury for testimony given in his unsuccessful legal action to recover the items seized by the police.

Upon being notified of appellant's arrest, respondent determined that the circumstances indicated that collection of his personal income tax liability for the period in issue would be jeopardized by delay; the subject jeopardy assessment was subsequently issued. In issuing the jeopardy assessment, respondent utilized the

cash expenditures method and determined that appellant's total taxable income during the appeal period was $95,000.

Appellant petitioned for reassessment of the subject jeopardy assessment, claiming that he had not engaged in any income producing activities during the period in issue and that the $42,000 discovered at the time of his arrest constituted his life savings. Despite respondent's repeated requests, however, appellant did not demonstrate how or when his purported life savings were accumulated. Accordingly, respondent affirmed its jeopardy assessment, thereby resulting in this appeal.

Subsequent to the filing of this appeal, respondent discovered that it had incorrectly reconstructed the amount of appellant's income. Respondent originally computed that appellant's taxable income consisted of: (i) the $42,000 found in his possession on March 18, 1978; (2) a $3,000 cost of living for the eleven-week appeal period: and (iii) an estimated $50,000 paid for the property uncovered at the time of his arrest. Respondent now believes that the $50,000 figure attributed by the police to the property seized in appellant's residence represented its fair market value, rather than its cost to appellant. Based upon data obtained from the Concord Police Department to the effect that a "fence" will pay only approximately 25 percent of the fair market value of stolen property, respondent now concedes that, under the cash expenditure method, the inclusion of the fair market value of the seized property was in error and that only 25 percent of that amount, i.e., $12,500, should have been included in its computation of appellant's income. In addition, while respondent included the entire $42,000 found on March 18, 1978, in appellant's taxable income during the appeal period, it now concedes that the proper amount should be only $40,000. In view of information included in appellant's 1977 return revealing approximately $2,000 maintained in a savings account, respondent believes that this amount should not be reflected in the reconstruction of appellant's income. Thus revised, respondent computes appellant's taxable income during the subject period at $55,500 ($40,000 + $12,500 + $3,000), with a resulting tax liability of $5,159.40.

At the oral hearing conducted before this board, appellant maintained that a substantial portion of the property seized by the police had subsequently been returned to him, and should not be considered

stolen property. Moreover, he claimed that these items had been acquired by him over a period of many years and that the values attributed thereto were exaggerated. Subsequent to the oral hearing, appellant provided this board a letter from a Pittsburg, California, jeweler stating that "the total aggragate [sic] value of the 14 [rings] would be perhaps $100.00." The rings were not identified as those seized at the time of appellant's March 18, 1978, arrest. In addition to the above, appellant also supplied an itemized list of the aforementioned 111 items, detailing their cost, from whom and when they had been purchased, and whether they had been returned to him by the police. The itemized list was not supplemented by any documentation, and appellant claims he drafted the list based upon recollection. This list was offered by appellant to demonstrate that: (i) the amounts paid for these items should not be included in a cash expenditure reconstruction of his income for the appeal period since only a handful of items were purchased during that period; (ii) the subject property cost substantially less than the $12,500 computed by respondent; and (iii) the items allegedly returned to him by the police should not be considered stolen. Finally, appellant also offered a schedule of unemployment insurance benefits paid to him before, during, and after the appeal period. Appellant maintains that this schedule supports his position that: he was not engaged in any income producing activities during the period in issue.

Under the California Personal Income Tax Law, taxpayers are required to specifically state the items of their gross income during the taxable year. (Rev. & Tax. Code, § 18401.) Each taxpayer is required to maintain such accounting records as will enable him to file an accurate return. (Treas. Reg. 1.446-1(a)(4); Former Cal. Admin. Code, tit. 18, reg. 17561, subd. (a)(4), repealed July 25, 1981, Reg. 81, No. 26.) In the absence of such records, the taxing agency is authorized to compute a taxpayer's income by whatever method will, in its judgment, clearly reflect income. (Rev. & Tax. Code, § 17651, subd. (b); Int. Rev. Code of 1954, § 446 (b).) The existence of unreported income may be demonstrated by any practical method of proof that is available. (Davis v. United States, 226 F.2d 331 (6th Cir. 1955); Appeal of John and Codelle Perez, Cal. St. Bd. of Equal., Feb. 16, 1971.) Mathematical exactness is not required. (Harold E. Harbin, 40 T.C. 373, 377 (1963).) Furthermore, a reasonable reconstruction of income is presumed correct, and the taxpayer bears the burden of

proving it erroneous. (Breland v. United States, 323 F.2d 492, 496 (5th Cir. 1963); Appeal of Marcel C. Robles, Cal. St. Bd. of Equal., June 28, 1979.)

It has been recognized that a dilemma confronts the taxpayer whose income has been reconstructed. Since he bears the burden of proving that the reconstruction is erroneous (Breland v. United States, supra), the taxpayer is put in the position of having to prove a negative, i.e., that he did not receive the income attributed to him. In order to ensure that such a reconstruction of income does not lead to injustice by forcing the taxpayer to pay tax on income he did not receive, the courts and this board require that each element of the reconstruction be based on fact rather than on conjecture. (Lucia v. United States, 474 F.2d 565 (5th Cir. 1973); Appeal of Burr McFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 1976.) Stated another way, there must be credible evidence in the record which, if accepted as true, would "induce a reasonable belief" that the amount of tax assessed against the taxpayer is due and owing. (United States v. Bonaguro, 294 F.Supp. 750, 753 (E.D.N.Y. 1968), affd. sub nom., United States v. Dono, 428 F.2d 204 (2d Cir. 1970).) If such evidence is not forthcoming, the assessment is arbitrary and must be reversed or modified. (Appeal of Burr McFarland Lyons, supra; Appeal of David Leon Rose, Cal. St. Bd. of Equal., March 8, 1976.)

As previously noted, respondent utilized the cash expenditure method to reconstruct appellant's income. Specifically, respondent determined that: (i) appellant would have needed $3,000 to meet his cost of living for the period January 1, 1978, through March 18, 1978; (ii) appellant paid $12,500 for the property seized by the police at the time of his arrest; and (iii) all but $2,000 of the $42,000 seized on March 18, 1978, represented income to appellant during the appeal period. In arriving at these conclusions, respondent relied upon the Concord Police Department's $50,000 valuation of the 111 items, $30,000 of which was attributed to the aforementioned 14 rings, many of which had price tags attached to them when seized.

After carefully reviewing the record on appeal, we conclude that each of the elements of respondent's reconstruction formula is reasonable and that appellant nas failed to provide the evidence needed to prove that reconstruction erroneous. Initially, we find the aforementioned letter from the Pittsburg jeweler

regarding the value of the 14 rings to be insufficient evidence as to their true worth. That letter does not adequately describe the jewelry and there is no way to ascertain that it was the same jewelry seized on March 18, 1978. In addition, appellant has offered no explanation as to why the rings found at the time of his arrest carried price tags ranging from $775 to $2,795, nor has he established that the jewelry was ever returned to him. Indeed, the record of this appeal reveals that appellant was convicted of three counts of perjury for testimony given in connection with his unsuccessful, attempt to recover the items seized by the police. Appellant's unsupported assertions with respect to the jewelry, as well as with regard to the non-jewelry items, are insufficient to satisfy his burden of proof, especially in light of his record of perjury with respect to the same property. Furthermore, appellant has failed to establish any error in respondent's determination that all but $2,000 of the $42,000 in his possession at the time of his arrest constituted funds earned during the appeal period. Appellant's assertion that this amount constituted his life savings lacks credibility in view of his past history of maintaining his savings in a financial institution. Moreover, appellant lacks any records to show how or when those funds were earned. Finally, the fact that appellant received unemployment compensation during the appeal period is hardly dispositive as to the question of whether he was engaged in any illegal income producing activities during the subject period.

The subject jeopardy assessment is based upon all taxable income to appellant during the period in issue, not merely the income reflected in respondent's reconstruction thereof. (See Appeal of Philip Marshak, Cal. St. Bd. of Equal., March 31, 1982.) As noted above, appellant was receiving unemployment benefits during the appeal period despite substantial income from other activities. In view of this other income, the unemployment benefits appear to have been fraudulently obtained, and therefore are taxable. (See Rev. Rul.. 78-53, 1978-1 Cum. Bull. 22.)

For the reasons set forth above, we conclude that appellant received a total of $55,500, in addition to the previously mentioned unemployment benefits, in unreported taxable income during the appeal period. Respondent's jeopardy assessment shall be modified accordingly.

Appeal of Kenneth E. Sayne

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the petition of Kenneth E. Sayne for reassessment of a jeopardy assessment of personal income tax in the amount of $9,550 for the period January 1, 1978, through March 18, 1978, be and the same is hereby modified in accordance with this opinion. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 4th day of May, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

_____, Member